Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R00160003 [redacted]
25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R00160003 [redacted]

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

~~Secret~~

25X1

Doc/Ser

DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Hungary's Economic Strategy In Dealing With The Industrial West

~~Secret~~

ER IM 70-110
August 1970

Copy No. 43

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1
Excluded from automatic downgrading and declassification

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
August 1970

INTELLIGENCE MEMORANDUM

Hungary's Economic Strategy In Dealing With The Industrial West

Introduction

As East-West trade has expanded, the East European countries* have developed distinctive approaches to it, adapted to their own political and economic circumstances. Probably the most sensible and successful policies have emerged in Hungary. The Hungarians in the 1960s have managed to expand their trade with the West greatly while staying out of serious financial difficulties -- a considerable achievement in view of their heavy dependence on foreign trade. This memorandum will examine Hungary's strategy -- and its results -- in trade and financial dealings with the industrial West.**

** Eastern Europe refers to Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania.*
*** For purposes of this memorandum, the industrial West refers to Belgium-Luxembourg, France, West Germany, Italy, the Netherlands, Austria, Denmark, Norway, Sweden, Switzerland, the United Kingdom, Ireland, Canada, the United States, Japan, Australia, and New Zealand. Finland and South Africa are excluded.*

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Problems

1. In the mid-1950s, Hungary was seriously overextended in trading with the industrial West. The Hungarian National Bank owed well over $100 million to principal trading partners in Western Europe. With lagging export earnings, Hungary was hard pressed to meet the relatively short-term maturities on its Western obligations. But after the abortive revolution of 1956, the regime was able to make a fresh start with Soviet help; in 1957 the USSR paid off 90% of Hungary's hard currency debts. Because the USSR was willing to accept goods in repayment for the hard currency loan, Hungary found itself in a tenable financial position vis-a-vis the industrial West.

2. The regime learned its lesson. In the 1960s, even though sales to the industrial West grew rapidly -- exports tripled from 1959 to 1969 -- the leadership remained highly realistic about the uncertainty of exports to the West. About one-half of these exports are agricultural and food products, for which export prices rose substantially in the 1960s. Unfortunately they are subject to erratic fluctuations in domestic crops; they also face variable demand conditions and trade discrimination in a West European market increasingly saturated with protected agricultural output. Hungary's industrial exports -- especially intermediate manufactures -- benefited considerably from the boom in Western Europe during most of the 1960s. But, as the Hungarians realized, their industrial enterprises are mostly marginal suppliers, which are bound to suffer heavy losses in sales during periods of slowing growth or recession in the West.

3. This realistic view of Hungary's export position, together with fears of further West European integration and protectionism, has led the Kadar regime to adopt a highly selective trade and financial policy, which has been in many ways unique in Eastern Europe. Hungary has been no less eager to import from the West than other East European countries, but has been more cautious than most in buying on credit from the West.

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Import Policy

4. Although the Hungarians have run imbalances in trade with the industrial West and have incurred substantial indebtedness in the process, they have consistently tried to gear imports to the erratic growth of their exports. As shown in Table 1, the rate of growth of imports fell sharply in 1962 after exports had sagged in 1961, rose sharply in 1963-64 after exports had picked up in 1962-63, fell again in 1965 after exports had slackened in 1964, and moved roughly in step with exports throughout the rest of the 1960s. For the 1960s as a whole, exports rose at an average annual rate of 11.6% and imports at 10.8%. Other East European countries, on the other hand, especially Bulgaria and Romania, allowed imports from the West to rise not only rapidly but also consistently for several years in the 1960s in spite of erratic export earnings.

Table 1

Growth in Hungary's Trade with the Industrial West

Percentage Increase over Preceding Year

Year	Exports	Imports
1960	7.5	30.9
1961	0.6	10.4
1962	12.8	-1.3
1963	27.3	24.2
1964	9.7	21.2
1965	11.7	0.6
1966	17.2	4.6
1967	4.0	12.4
1968	-2.7	-3.6
1969	33.0	13.6

5. Another distinctive feature of Hungary's import policy has been the relatively small scale of purchases of machinery and equipment from the West. Hungary apparently has been less caught up in the race to broaden its industrial base and to diversify and upgrade its capital stock by infusing Western plant and equipment. Machinery imports

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

from the West have not been insignificant; in 1966-68 they were worth $285 million. But in the same period, Bulgaria bought $400 million, Czechoslovakia $562 million, and Romania $885 million. Only Poland had as low a per capita import of Western machinery and equipment in this period.

6. Imports of machinery account for a smaller share of total imports from the industrial West in Hungary than elsewhere in Eastern Europe. In 1968, imports of machinery made up one-fourth of Hungarian purchases in the industrial West; the next lowest share was Poland's, at 31%; Romania's was highest with 56%. Moreover, Hungary has purchased a smaller range of equipment and in smaller individual orders, especially compared with Bulgaria and Romania, a large part of whose machinery imports are purchases of complete plants. Hungary has tended to stress imports that help in modernizing and expanding existing plants.

7. Although importing less Western machinery, Hungary imports relatively more Western industrial materials. Bilateral trade with the Soviet bloc has largely supplied Hungary's needs for imports of coal, iron ore, oil, wood, and fertilizer, but Hungary has turned to the West for large imports of chemical raw materials to support the rapid growth of its petrochemical industry and for sizable imports of dyes, tanning and coloring agents, and textile materials to support its large textile industry. Imports of chemicals, textiles, and other raw and semifinished materials currently make up over 60% of total imports from the industrial West -- a far larger share than in most other East European countries. Imports used directly as inputs by the chemical industry represent an unusually high percentage of the value of output, rising to 30% of the output of mineral fertilizers and inorganic chemicals (in 1965). Industrial development has probably been less oriented toward import substitution in Hungary than in most other East European countries. Even so, the Hungarians lead in lamenting the ineffectiveness of import substitution as a policy and the part it has played in the long-run deterioration of Hungary's trade balance with the West.

8. Under the economic reform of 1968, which allows enterprises partial freedom to import what they want, the regime has continued to decide the

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

composition and level of imports from both East and West through selective "indirect" controls. These include credit restrictions and deposit requirements for some imports, differential exchange rates of 40 forints to the ruble and 60 forints to the dollar to encourage ruble imports (and dollar exports), and sharply differentiated tariffs which are directed solely at the West -- a point that the Hungarians avoid talking about.

9. Tariff rates vary a good deal. For example, the rate for railroad rolling stock and buses is 65% of the basic import price; for electric generators, 50%; and for machine tools, 35% to 50%. The Hungarians have stated that the purpose of these admittedly high rates for machinery is:

> ... to protect domestic products and socialist imports against relatively inexpensive machines from capitalist countries, to limit temporarily capitalist machine imports, and to keep the foreign currency outflow for this purpose below a certain level.

The tariffs, combined with the high forint/dollar rate, should help a good deal in controlling imports from the West.

10. The Hungarians continually dispute over the economic effect of high tariff rates -- and more or less liberal exemptions. But the regime must either keep to sharply differentiated tariffs as part of the elaborate system of "indirect" controls or else revert to systematic central control of trade. One way or another, the regime intends to direct foreign trade to desired ends.

<u>Cooperation Agreements</u>

11. The Hungarians have been far more forward about cooperating with Western firms than about buying from them. Hungary has been the leader in the Soviet bloc in undertaking licensing and cooperation agreements with the industrial West. The returns from license purchases have been disappointing, with directly attributable export earnings in the West amounting to barely $1 million annually thus far. Still, cooperation agreements have enabled Hungary to deepen economic relations with advanced Western firms in a number of useful ways,

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

including the domestic assembly of foreign parts, raw materials processing, joint production for third countries, and even joint companies. For example, Hungary's Gyor works has arranged with Renault-MAN-Ferrostahl to purchase plant and equipment and two licenses to manufacture MAN diesel engines; 60% was to be repaid by supplying engine spare parts and 40% in hard currency. Volkswagen and Shell have agreed to set up service stations in Hungary; in 1969 Shell agreed to set up 10 more stations and to accept forints as well as hard currency in payment. The stations will be supplied with Hungarian gasoline processed to Shell specifications. A joint company called Technotrans has been established between the Compagnie Francaise des Ferrailles and Technoimpex, with 60% of the capital put up by the French and 40% by the Hungarians. The company is to promote the sale of Hungarian machine tools, electric motors and electric appliances in France and to export French products to Hungary.

12. Hungary has been negotiating with two American firms -- Control Data Corporation and Ford Motor Company -- regarding proposals for investing capital in Hungary. [redacted] the Soviets have given tacit approval to Hungary to grant minority foreign ownership to Western investors, on a selective basis. Regulations concerning foreign investment are expected later this year. The level of activity in this field will probably depend, as in Yugoslavia, upon the potential of projects for earning hard currency, and the terms of repatriation of profits and capital.

25X1
25X1

Financial Dealings

13. Hungary's prudent trade policy has been complemented by a conservative financial policy. The regime's preference for buying Western machinery and equipment in small quantities instead of buying complete plants has required bankers and trade officials to know their business. They have made a serious effort to grasp the complexities of Western markets and the ins and outs of Western business and financial methods. As a result, Hungarian officials have gained a reputation for shrewd financial dealings with the West. They have been adept at arranging switch deals, engaging in Eurodollar

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

transactions, and otherwise getting the most for their deposits in Western money markets. And they have been hard-nosed bargainers, refusing to follow Bulgaria and Romania down the road of heavy borrowing in the West.

14. The quest for bargains has many times taken precedence over the desire for capital equipment. Hungarian trade negotiators, compared with those in some East European countries, have been less willing to accept inferior credit terms and excessive prices. As early as 1959, Hungary was trying to switch as much trade as possible away from West Germany to other Western European countries due to a "difficult credit situation" in West Germany. Several deals fell through in 1959 solely because of high West German credit charges. In 1963, Hungary was obtaining one-year credits at a respectable 3% interest rate for raw materials imports from Western Europe, but was still pushing for terms of five years on purchases as small as $150,000. The Hungarians have frequently played one Western supplier against another, claiming a better deal elsewhere, and in general trying to heighten Western competition for East European business. It is likely that the rapid improvement in East European credit availabilities in Western Europe in the 1960s can be traced in part to Hungary's stubborn efforts.

15. Financial conservatism on the part of bankers and trade officials is reflected in the gradual rise in Hungarian indebtedness. Since 1964, when indebtedness rose some $80 million, partly as a result of a 300,000 ton ($15 million) grain purchase, the increments have not run above 10% of the value of exports -- that is, about the average expected increase in the value of exports. In other words, Hungary has apparently decided to maintain indebtedness at roughly one-half the value of exports, a fairly conservative policy by East European standards. This policy has kept Hungary from the imprudent conduct of Bulgaria, which in 1968 owed double the amount of its exports and had to call on the USSR for help and guidance. Nor can Hungary afford the heavy purchases of Romania, which now owes 140% of its annual exports. And Hungary has been less willing to take risks than Czechoslovakia and Poland -- both of which owe well over one-half the value of their annual exports to the industrial West.

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

16. As trade with the industrial West has evolved from bilateral clearing agreements to multilateral hard currency trade, and as Hungary's credit worthiness has been established in Western Europe, the mode of its import financing in the West has changed markedly -- as it has for other East European countries. Hungarian short-term indebtedness has changed from 180 day to 360 day overdrafts on swing balances, to short-term hard currency acceptance credits and current account supplier credits, as well as other types of facilities which can readily be converted into medium-term facilities as the need arises. Medium and long-term credits formerly secured by gold are now financed in most cases merely on the basis of East European central bank guarantees. The development of trade also has been promoted by the liberalization and expansion of Western export credit guarantee services. Since the late 1950s, Hungarian commercial paper has moved rather freely in Western money markets, at respectable and stable discount rates. It has generally not suffered the periodic loss of confidence (as reflected in high discount rates) to which the commercial paper of Yugoslavia (in the 1950s), Bulgaria, and Romania has been subjected.

17. An important factor in the expansion of East-West trade has been the activities of Soviet-owned banks in Western Europe, which have encouraged and taken part in Western lending to Eastern Europe. Hungary has made extensive use of short and medium-term credit facilities offered by the Moscow Narodny Bank (MNB) in London, and the Banque Commerciale Pour L'Europe du Nord (BCEN or Eurobank) in Paris -- the two largest such institutions. Since the early 1960s, Eurobank has been far less active in direct lending than has the MNB. By the late 1960s, probably over three-fourths of East European direct borrowing from the two banks was conducted with MNB. Until the mid-1960s, these banks dealt almost exclusively with short-term financing (18 months or less) serving as an outlet for East European gold as collateral or for sale, and otherwise bridging the business communications gap between the East and the West. Since the mid-1960s, the two banks have offered small amounts of medium-term credit, most of which has come from the MNB. Other Western financial institutions -- in Italy, West Germany, France, Austria, the United Kingdom, and Switzerland -- have supplied most of Eastern Europe's needs

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

for medium and long-term credit. At the present time, the share of the BCEN and the MNB in total East-West trade financing is not very large. Nevertheless, their discounting and Eurocurrency operations play an important role in assuring a smooth flow of credit to Eastern Europe.

18. Hungary generally has conducted gold transfers and Eurocurrency dealings as well as deposit banking business with the BCEN (which offered better rates) and has conducted credit operations through both banks, using the BCEN for most business in Continental Europe, Africa, and Asia, and using the MNB for dealings within the sterling area. Until the early 1960s, Hungary's dealings with the MNB were fairly limited; relations had never been particularly good and there often were difficulties between them. [redacted] 25X1 25X1

By early 1966, about 70% of Hungary's imports from the sterling area were transacted through the MNB. Hungary is currently channeling a significant part of its short-term business through both the BCEN and the MNB, with total deposits (assets) and credit liabilities amounting to an average of perhaps $75 million to $100 million at any one time. As with other East European countries, however, most of Hungary's medium and long-term indebtedness is owed to other financial institutions in the West.

Balance of Payments with the Industrial West

19. Hungary probably owes less money in the West than does any other East European country except Bulgaria which, with Soviet assistance, has substantially reduced its indebtedness since 1968. At the present time, Hungarian indebtedness on medium (under 5 years) and long-term (over 5 years) is roughly $260 million to $270 million, of which roughly $200 million is owed to NATO trading partners in the industrial West; and $60 million to $70 million is owed to non-NATO partners -- Austria, Switzerland, Sweden, and Japan. This does not include $60 million to $70 million on short-term, most of which must be turned over yearly. In contrast, Romania owes about $700 million, Czechoslovakia, about $400 million, Poland, $600 million (excluding US PL-480 credits), and East Germany, about $700 million (including overdrafts on its swing balance with West Germany).

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Current Account

20. Balances on current account with Western partners seem to bear little relation to purchases on credit from them. Austria, France, and the United Kingdom have large cumulative surpluses in trade with Hungary. Hungary, on the other hand, has cumulative surpluses of over $100 million with both Italy and Switzerland. Trade with West Germany has very nearly balanced out; Hungary has a cumulative deficit of only $23 million. The Hungarians have bought on credit from both groups of partners and from West Germany, as well as from all of their significant trading partners in Europe. In other words, trade with these countries is truly multilateral; convertible surpluses with some countries are freely used to settle deficits with others. This flexibility doubtless helps Hungary to maintain liquidity.

21. Hungary's trade with Western bilateral soft currency trading partners who, by definition, are not part of the industrial West has been a significant source of non-monetary medium-term credit for Hungary, and thus a further means of increasing liquidity and flexibility. Since 1964, Hungary has incurred a trade deficit of about $100 million with these countries, including India, Finland, Greece, Turkey, Spain, and Brazil. This figure does not include less developed hard currency trading partners, the net earnings from whom are included in the current account balance as a probable source of hard currency. In 1969, Hungary ran a small surplus in bilateral soft-currency trade and appeared to have begun an effort to bring it into balance.

22. As shown in Table 2, Hungary's cumulative trade deficit with the industrial West in the period 1959-69 was $460.8 million. Except for 1959, 1966, and 1969, annual trade deficits in this period exceeded $40 million. In 1969, exports increased $124 million, and Hungary ran its only trade surplus of the 1960s -- amounting to $19 million.

23. The data given for commodity trade are official Hungarian statistics, which follow general Western practice in showing exports f.o.b. and imports c.i.f. the Hungarian border. Consequently,

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

SECRET

Table 2

Hungarian Balance of Payments with the Industrial West

Million US $

	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	Total 1959-69
Commodity trade												
Exports f.o.b.	166.1	178.6	179.7	202.7	258.1	283.2	316.4	370.8	385.6	375.2	499.0	3,215.4
Imports c.i.f.	172.7	226.0	249.6	246.3	305.9	370.9	373.0	390.0	438.5	422.9	480.4	3,676.2
Balance on trade	-6.6	-47.4	-69.9	-43.6	-47.8	-87.7	-56.6	-19.2	-52.9	-47.7	+18.6	-460.8
Tourism a/	0.6	1.3	1.7	1.9	1.1	2.3	7.2	11.2	10.7	10.6	13.1	61.7
Transportation	4.5	4.8	4.9	5.5	7.0	7.6	8.5	10.0	10.4	10.1	13.5	86.8
Remittances	6.2	6.3	5.7	7.3	3.5	3.5	3.3	3.5	3.7	3.8	4.7	51.5
Compensation payments	-1.3	-1.6	-1.6	-0.9	-1.1	-1.4	-1.2	-1.3	-1.7	-1.6	-1.5	-15.2
Subscriptions to international organizations	-0.6	-0.6	-0.6	-0.8	-0.8	-1.2	-1.2	-3.4 b/	-1.4	-1.4	-1.4	-13.4
Net interest income	-3.4	-4.0	-4.5	-4.8	-6.1	-10.4	-14.6	-15.7	-17.4	-20.9	-24.1	-125.9
Net hard currency trade with less developed countries	+3.2	+8.0	+7.6	+1.5	-2.6	-8.8	+1.4	-3.8	+6.0	+9.7	+15.4	37.6
Balance on current account	+2.6	-33.2	-56.7	-33.9	-46.8	-96.1	-53.2	-18.7	-42.6	-37.4	+38.3	-377.7
Capital account												
Short term borrowing												
Drawings	20	24	23	25	32	39	42	47	53	56	60	
Repayments	-20	-20	-24	-23	-25	-22	-47	-51	-46	-50	-56	
Medium and long-term borrowing												
NATO drawings	18	24	22	27	34	70	51	47	45	54	45	
Other drawings	3	5	3	5	8	13	11	9	10	13	11	
Repayments	-6	-7	-16	-21	-21	-19	-29	-34	-41	-45	-50	
Net foreign investment, West	15	26	8	13	28	82	28	18	21	28	10	276.0
Repayments on 1958 Chinese loan c/	0	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-30.0
Total net foreign investment	15	23	5	10	25	78	25	15	18	25	7	246.0
Monetary gold and foreign exchange reserves	--	-1.0	-2.0	-2.0	-2.0	-2.0	--	--	--	--	-25.0	-34.0
Clearing account balances	1.6	7.6	12.7	21.0	36.6	2.3	-3.3	-15.1	13.2	4.2	-11.1	69.7
Other transactions and errors and omissions	-19.2	3.6	41.0	4.9	-12.8	17.8	31.5	18.8	11.4	8.2	-9.2	96.0
Balance on capital account	-2.6	33.2	56.7	33.9	46.8	96.1	53.2	18.7	42.6	37.4	-38.3	377.7

a. Including international fare payments and visas.
b. Including $2.1 million in hard currency subscription to the CEMA Bank which fell due in 1966.
c. A hard currency loan of $30 million, assumed to have been paid off in equal installments during 1960-69. Estimated interest on this loan is included in the current account.

SECRET

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

transportation charges for imports are included in the trade statistics. The Hungarians earn something on balance from other transportation -- net receipts from export deliveries and fees for freight transiting Hungary. These earnings, which are included under service transactions, are estimated from a Hungarian figure for gross hard currency transport earnings for 1969 -- $43.? million or 8.7% of exports in 1969. Gross earnings are partly offset by Hungarian payments for transport fees on exports to the West such as shipping and port charges. These fees are substantial, averaging about 6% of Hungarian exports to such countries as the United Kingdom, West Germany, France, Belgium, the Netherlands, Sweden, and Norway. Thus a net percentage of 2.7% of exports is estimated to represent transport earnings for 1959-69.*

24. The other large source of hard currency in the services account now is net tourist earnings, reflecting intensive efforts since the mid-1960s to expand tourist accommodations. Hungarian hotels reportedly even discriminate against tourists from other Communist (that is, soft currency) countries in favor of Westerners with dollars, in order to maximize earnings in hard currency. Net tourist earnings in 1959-65 are taken from a Hungarian tourism publication,** and earnings for 1966-69 are estimated from Hungarian data on tourist traffic and on average spending of Western and Hungarian tourists. Remittances -- hard currency earned abroad and sent to Hungary -- dominated invisibles earnings through the early 1960s, but have declined in importance since then. Estimated remittances are based on data from the United States, which is believed to account for 40% of total remittances from the industrial West.

25. Net interest payments on outstanding indebtedness have been smaller than for most other East European countries not only because the Hungarians have owed less money over the years than most other East European countries but also because they were more particular about interest rates in

* *If the transport cost included in imports is counted, however, the Hungarians incur a substantial deficit in net transport earnings -- probably exceeding $25 million in 1969.*

** Idegenforgalmi Adattar, *1966.*

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

incurring debts. Interest payments did not become a significant item until the mid-1960s. By contrast, Romanian interest costs in the West at that time were twice those of Hungary and have continued to grow substantially since then. Hungary's net hard currency trade with less developed countries is included in the current account, because net earnings from this source can be applied to reducing indebtedness to the industrial West or adding to reserves of gold or hard currency. For the same reason, interest payments include the charges on a $30 million Chinese hard currency loan granted in 1958.

Capital Account

26. Hungarian deficits for trade and services and net earnings from less developed hard currency trading partners combined to produce a cumulative deficit on current account with the industrial West of about $380 million during 1959-69. This deficit was covered largely by commercial credits and untied Eurocurrency bank loans granted in Western Europe to finance purchases mainly of machinery and equipment and semifinished manufactures and raw materials. These may well have been underestimated, given the significant residual representing errors and omissions.

27. In a recent press release,* Bela Csikos-Nagy, the chairman of the reform-initiated National Materials and Price Control Board, stated that "Hungary's liabilities to its Western partners, resulting from trade between 1965 and 1969, amount to 2 billion foreign exchange forint" (roughly $170 million). It is not known whether this refers only to a hard currency bank debt, or whether it also includes imbalances in clearing accounts with Western soft-currency partners -- a form of non-monetary debt, since almost all such imbalances are settled through goods shipments. If the reference is to bank credits alone, then probably a significant portion of the errors and omissions residual for 1965-69 represents additional medium and long-term drawings over and above the estimated levels, which would increase the indebtedness to $325 million-$350 million. If soft-currency clearing account balances are included in the

* Magyar Hirlap, *10 February 1970.*

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

$170 million, then the estimates of medium and long-term drawings as they stand are fairly accurate.

28. Short-term and extended short-term (90 days to 2 years) borrowings are assumed to cover at least 15% of imports of raw materials and semi-finished goods, with most drawings being cancelled out by repayments within 12 months. Drawings on short-term credit in 1969 are estimated at about $60 million. Since the mid-1960s, medium and long-term drawings have averaged about $55 million to $60 million annually, principally to cover imports of machinery and semimanufactures. NATO drawings for 1966-69 were derived by lagging credit extensions reported by NATO members. They were then calculated as a share of imports of Western machinery and equipment for those years, and the average share (52%) was then moved back to 1959. NATO credits have averaged about 80% to 85% of the total. Repayments on medium and long-term credit from the industrial West have increased substantially since 1964, reaching a peak of $50 million in 1969.

29. Official figures on monetary gold and foreign exchange reserves were last published in 1950, when Hungary held the equivalent of $41 million. Hungary sold perhaps $15 million worth of gold in 1957 in order to pay off roughly 10% of its indebtedness to the West, the remainder having been settled by the USSR, as noted earlier. In 1965, an official of the Hungarian National Bank mentioned a current gold reserve figure of $35 million. It is presumed that the Hungarians could have added $9 million to their gold supply between 1960 and 1964. Accumulation of foreign exchange reserves is assumed to have been negligible until 1969, when hard currency reserves probably were built up to perhaps $25 million. Clearing account balances represent trade balances with bilateral trading partners (France until 1964, Austria, and Switzerland), where provision for swing balances has been made. Hungary has used such deficit balances on occasion as a source of short and medium-term credit. It is assumed that deficits on clearing balances have been liquidated under the terms of swing limits agreements through repayments in goods or by conversion into medium-term indebtedness.

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

The Seventies

30. No major change in strategy is expected in the 1970s. The Hungarians are expected to follow the conservative policies that have kept them from serious balance-of-payments problems with the West. Imports will continue to be manipulated in line with exports, and Hungarian officials will remain selective in their credit dealings with the West. An added incentive for caution has been provided by the economic reform of 1968, which has left the leadership more open to criticism -- both from within and from the USSR. Already highly reluctant to have to call on the USSR again to bail them out of any financial difficulties with the West, the Hungarians may tread even more carefully, at least until the reform is fully phased into the economy.

31. As far as trade with the industrial West is concerned, the reform is a logical extension of the strategy that has emerged since the late 1950s. The reforms have sharpened incentives for exporting to the West and have refined the technique of determining the volume and structure of imports from the West. "Indirect" controls, backed up with the power to impose direct controls if need be, represent a further attempt to steer exporters to sales opportunities in the West. Moreover, some enterprises have been given greater authority to conduct their own trade instead of working exclusively through state trading firms. This should facilitate increased firm-to-firm contact and more cooperation agreements with the West.

32. Some Hungarian officials have credited the reform with playing a major role in stimulating exports and hence achieving a favorable balance of payments with the West in 1969. In reality, the 33% increase in exports to the industrial West in 1969 is explained by a record harvest, a quick revival of meat sales to Italy, and a substantial rise in prices on the Western market, particularly in West Germany. The record was set straight by Hungary's foreign trade minister, Jozsef Biro:

> The favorable achievements of foreign trade in 1969 largely resulted from increased exports of basic materials and agricultural produce. However, the ability of processed

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

industrial goods to compete in capitalist markets can still not be said to be satisfactory.

Thus far, the only major change that can be attributed even indirectly to the reform is an increased emphasis on imports of Western consumer goods. Anxious to give tangible evidence to its citizens of the success of the reforms, the government has announced plans to increase consumer goods imports by 70% in 1970, with an unprecedented $29 million allocated for purchases of clothing and other consumer manufactures.

33. Tangible results from the reform in promoting exports probably will come slowly if at all. Factors such as domestic crop conditions and variable foreign demand for Hungarian products doubtless will continue to dominate -- and at times disturb -- Hungary's export performance in the 1970s. And factors outside the reform itself, such as selective borrowing from the West in support of export industries, probably will account for any significant improvements that may take place in the structure of exports in the 1970s. For example, plans for the aluminum industry -- already a major hard currency earner -- should shortly make it the most important exporter to the West within the manufacturing sector. This industry is slated for huge investments, large Soviet credits, and integration with the Soviet aluminum industry. In addition, Hungary recently borrowed $15 million from a London-based consortium for purchases of advanced Western equipment and technology to make the industry more competitive on world markets. Another rising export industry -- pharmaceuticals -- has received a loan of $30 million from a Western consortium, enough to cover about one-third of the total investment outlays scheduled for this industry during 1971-75.

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6

Conclusions

34. Hungary's strategy in trade with the West since the late 1950s probably has been the most successful in Eastern Europe. This strategy, evolving from a realistic assessment by the Hungarians of their ability to export to the West, has combined import restraint and careful credit dealings with forward-looking cooperation agreements with Western firms. As a result, Hungary today owes less money to the West than the other East European countries except Bulgaria, and is in a relatively better position to continue to expand trade with the West in the 1970s without incurring serious financial problems. The Hungarians have indeed learned a lesson from the mid-1950s, when they were extricated from heavy hard currency debts by the USSR.

35. Hungary still will have difficulty in sustaining increases in exports to the West. The mainstay of exports in the 1970s as before will be sales of agricultural products -- which still will be as erratic as Hungarian weather conditions. Greater efforts will be made to make industrial output more competitive, and the reforms should help to focus enterprise attention on opportunities in Western markets. However, Hungary will continue to rely heavily on import controls and on the ingrained conservatism of its banking and trade officials to hold down its balance-of-payments deficits with the West.

Declassified in Part - Sanitized Copy Approved for Release 2011/10/31 : CIA-RDP85T00875R001600030110-6